

# Chapter 1

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## The Financial Statements

### Short Exercises

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(5 min.) S 1-1

1. **Assets** are resources controlled by the company as a result of past events and from which the company expects to receive future economic benefits.

**Shareholders' equity** represents the insider claims of a business, the claims to the assets held by the owners of the business.

**Assets and shareholders' equity** differ in that shareholders' equity is a claim to assets.

**Assets** must be at least as large as shareholders' equity. **Equity** can be smaller than assets.

2. Both liabilities and shareholders' equity are claims to assets.

**Liabilities** are the *outsider* claims to the assets of a business. **Shareholders' equity** represents the *insider* claims to the assets of the business.

(5 min.) S 1-2

**Total assets = Total liabilities + Shareholders' equity**

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a) **\$300,000 = \$150,000 + \$150,000**

b) **290,000 = 90,000 + 200,000**

c) **220,000 = 100,000 + 120,000**

**A different presentation should be:**

a) **Total assets = Total liabilities + Shareholders' equity**  
**= \$150,000 + \$150,000 = \$300,000**

b) **Shareholders' equity = Total assets – Total liabilities**  
**= \$290,000 – \$90,000 = \$200,000**

c) **Total liabilities = Total assets – Shareholders' equity**  
**= \$220,000 – \$120,000 = \$100,000**

(5 min.) **S 1-3**

**1. Owners' Equity = Assets – Liabilities**

It would not change in analyzing a household or a neighbourhood restaurant's information.

**2. Liabilities = Assets – Owners' Equity**

(5-10 min.) **S 1-4**

- |                      |          |                             |          |
|----------------------|----------|-----------------------------|----------|
| a. Accounts payable  | <u>L</u> | g. Accounts receivable      | <u>A</u> |
| b. Common shares     | <u>E</u> | h. Long-term debt           | <u>L</u> |
| c. Cash              | <u>A</u> | i. Merchandise inventories  | <u>A</u> |
| d. Retained earnings | <u>E</u> | j. Notes payable            | <u>L</u> |
| e. Land              | <u>A</u> | k. Accrued expenses payable | <u>L</u> |
| f. Prepaid expenses  | <u>A</u> | l. Equipment                | <u>A</u> |

(5 min.) **S 1-5**

**1. *Income and expenses***

**2. Net income, or net earnings (or net loss, if negative)**

(10 min.) S 1-6

**Split Second Wireless Inc.**  
**Statement of Income**  
**For the Year Ended December 31, 2017**  
*(In millions)*

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<b>Net revenue</b>	<b>\$ 90</b>
<b>Expenses</b>	<b><u>20</u></b>
<b>Net income</b>	<b><u>\$ 70</u></b>

(5 min.) S 1-7

**Mondala Ltd.**  
**Statement of Retained Earnings**  
**For the Year Ended December 31, 2017**  
*(In millions)*

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<b>Retained earnings:</b>	
<b>Balance, beginning of year.....</b>	<b>\$200</b>
<b>Net income (\$400 – \$300) .....</b>	<b>100</b>
<b>Less: Dividends.....</b>	<b><u>(40)</u></b>
<b>Balance, end of year .....</b>	<b><u>\$260</u></b>

**Skate Sharp Limited**  
**Balance Sheet**  
**December 31, 2017**

<b>ASSETS</b>	
<b>Current assets:</b>	
Cash .....	\$ 13,000
Receivables .....	2,000
Inventory .....	<u>40,000</u>
Total current assets .....	55,000
Equipment.....	75,000
Other assets .....	<u>10,000</u>
<b>Total assets .....</b>	<b><u>\$140,000</u></b>
<b>LIABILITIES</b>	
<b>Current liabilities:</b>	
Accounts payable .....	\$ 10,000
Short-term notes payable.....	<u>5,000</u>
Total current liabilities.....	15,000
<b>Long-term liabilities:</b>	
Long-term debt.....	<u>70,000</u>
<b>Total liabilities</b>	<b><u>85,000</u></b>
<b>SHAREHOLDERS' EQUITY</b>	
Contributed capital .....	15,000
Retained earnings .....	<u>40,000*</u>
Total shareholders' equity .....	<u>55,000</u>
<b>Total liabilities and shareholders' equity.....</b>	<b><u>\$140,000</u></b>

**\*Computation:**

**Total assets (\$140,000) – current liabilities (\$15,000) – long-term debt (\$70,000) – contributed capital (\$15,000) = \$40,000**

**Brazos Medical Inc.  
Statement of Cash Flows  
Year Ended December 31, 2017**

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**Cash flows from operating activities:**

Net income .....	\$ 120,000
Adjustments to reconcile net income to net cash provided by operating activities .....	<u>(20,000)</u>
Net cash inflow from operating activities ...	100,000

**Cash flows from investing activities:**

Purchases of equipment .....	\$(300,000)
Sale of equipment .....	<u>60,000</u>
Net cash outflow from investing activities	(240,000)

**Cash flows from financing activities:**

Borrowing on long-term note payable .....	\$150,000
Payment of dividends .....	<u>(15,000)</u>
Net cash inflow from financing activities ...	<u>135,000</u>
Net increase (decrease) in cash .....	(5,000)
Cash balance, December 31, 2016.....	<u>24,000</u>
Cash balance, December 31, 2017.....	<u>\$ 19,000</u>

(5 min.) **S 1-10**

1. The *separate-entity assumption* applies.
2. Application of the separate-entity assumption will separate Grant's personal assets from the assets of the business. This information will show how much in assets the business owns and this knowledge will help him evaluate the business realistically.

(5 min.) **S 1-11**

**Standards of professional conduct are designed to produce information that has predictive or confirming value and is completely free from bias and without material error. This is information that can be used for decision making.**

**If there were no standards, companies could be motivated to report information to make their company look good. This could provide external users with inappropriate information.**

(10 min.) S 1-12

- a. Dividends SRE, SCF
- b. Salary expense IS
- c. Inventory BS
- d. Sales revenue IS
- e. Retained earnings SRE, BS
- f. Net cash provided by operating activities SCF
- g. Net income IS, SRE, SCF (if prepared by the indirect method)
- h. Cash BS, SCF
- i. Net cash provided by financing activities SCF
- j. Accounts payable BS
- k. Common shares BS
- l. Interest revenue IS
- m. Long-term debt BS
- n. Net increase or decrease in cash SCF



## Exercises

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(10 min.) E 1-13

- a. **Corporation.** If the corporation fails and cannot pay its liabilities, creditors cannot force shareholders to pay the business's debts from their personal assets. Therefore, the most an investor can expect to lose on an investment in a corporation is the amount invested.
- b. **Proprietorship.** There is a single owner of the business, so the owner has absolute control over the business.
- c. **Partnership.** If the partnership fails and cannot pay its liabilities, creditors can force the partners to pay the business's debts from their personal assets. A partnership affords more protection for creditors than a proprietorship because there are two or more owners to share this personal liability for the business's debts. If the partnership is a LLP (limited liability partnership) claims are limited to the partnership assets, similar to a corporation. Limited liability partnerships tend to be professional firms, i.e., accountants, lawyers.

**What form of business organization would you choose?**

**The answer depends on your objective. If you want to maintain absolute control of the business, you may prefer to organize as a *proprietorship*. If your objective is to maintain a high degree of control but you need additional money or expertise, a *partnership* may work for you. If you want the business to grow large, or if you wish to avoid personal liability for business debts, you should organize as a *corporation*.**

The *income statement* reports the revenues and expenses of a particular entity for a period such as a month or a year. Total *revenues* minus total *expenses* equals *net income*, or profit. A lender would require this information in order to predict whether the borrower can generate enough income to repay the loan.

The *balance sheet* reports the assets, liabilities, and owners' equity of the entity at a particular point in time. The *assets* show the resources that the business has to work with. Because borrowers pay loans with assets, a lender wants to know the business's assets (especially cash). *Liabilities*—debts—represent creditors' claims to the business's assets. *Owners' equity* is the portion of the business assets owned outright by the owners.

**Note:** Student responses may vary.

(5-10 min.) E 1-15

- a. Historical-cost assumption – the amount received from the sale.
- b. Going-concern assumption – Trammel Crow Realtors will stay in business long enough to use existing assets for their intended purposes.
- c. Separate-entity assumption – each division records information as a separate economic unit.
- d. Historical-cost assumption – assets should be recorded at actual cost of purchase.

(5-15 min.) E 1-16

*(Amounts in millions)*

	<b>Assets</b>	<b>=</b>	<b>Liabilities</b>	<b>+</b>	<b>Owners' Equity</b>
<b>Telus</b>	<b>\$16,987</b>		<b>\$10,061</b>		<b>\$6,926</b>
<b>Scotiabank</b>	<b>411,510</b>		<b>392,706</b>		<b>18,804</b>
<b>Shoppers Drug Mart</b>	<b>5,644</b>		<b>2,434</b>		<b>3,210</b>

Req. 1

(Amounts in millions)

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Shareholders'</u> <u>Equity</u>
Current	\$ 633.6		\$ 591.2		
Capital	1,126.7				
Other	<u>1,237.5</u>		<u>1,245.2</u>		
Total	\$2,997.8	=	\$1,836.4	+	\$1161.4
	↑		↑		↑
	<i>Req. 2</i> Resources to work with		<i>Req. 3</i> Amount owed to creditors		<i>Req. 4</i> Actually owned by the shareholders

(10-20 min.) E 1-18

	Situation		
	1	2	3
	<i>(Millions)</i>		
<b>Total shareholders' equity</b>			
December 31, 2016 (\$30 – \$8).....	\$22	\$22	\$22
<b>Add: Issuance of shares</b> .....	2	0	11
Net income.....	6	11	
<b>Less: Dividends</b> .....	0	(3)	(2)
Net loss.....	0	0	(1)
<b>Total shareholders' equity,</b>			
December 31, 2017 (\$40 – \$10)	\$30	\$30	\$30

**1. Mortimer Limited**

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Shareholders' Equity</u>
Beginning	\$700,000	=	\$400,000	+	\$300,000
Multiplier for increase	<u>× 1.20</u>				
Ending	<u>\$840,000</u>				

**2. Aztec Associates**

	<u>Assets</u>	-	<u>Liabilities</u>	=	<u>Shareholders' Equity</u>
Beginning amount	\$500,000	-	\$200,000	=	\$300,000
Net income					<u>\$100,000</u>
Ending amount					<u>\$400,000</u>

**(10-15 min.) E 1-20**

- a. Balance sheet**
- b. Balance sheet**
- c. Statement of retained earnings, Statement of cash flows**
- d. Income statement**
- e. Balance sheet, Statement of retained earnings**
- f. Balance sheet**
- g. Balance sheet**
- h. Income statement**
- i. Statement of cash flows**
- j. Income statement**
- k. Statement of cash flows**
- l. Balance sheet, Statement of cash flows**
- m. Balance sheet**
- n. Income statement, Statement of retained earnings, Statement of cash flows**
- o. Income statement**



**Torrance Associates Inc.**  
**Balance Sheet as at**  
**December 31, 2017**  
(in millions)

ASSETS		LIABILITIES	
Cash	\$28		
Investments	72	Current liabilities	\$290
Receivables	253	Long-term liabilities	73
Other assets	43		
Property and equipment, net	4	Total liabilities	<u>363</u>
		<b>SHAREHOLDERS' EQUITY</b>	
		Common shares	12
		Retained earnings	<u>25*</u>
		Total shareholders' equity	<u>37</u>
Total assets	<u>\$400</u>	Total liabilities and shareholders' equity	<u>\$400</u>

**\*Computation:**

Retained earnings = Total assets (\$400) – Total liabilities (\$363) – Common shares (\$12) = \$25

**Torrance Associates Inc.  
Income Statement  
For the Year Ended December 31, 2017**

	<i>(millions)</i>
Total revenue.....	\$35
Expenses:	
Salary and other employee expenses .	\$9
Interest expense .....	3
Other expenses .....	<u>14</u>
Total expenses .....	<u>26</u>
Net income before tax .....	<u>\$ 9</u>

**Torrance Associates Inc.  
Statement of Retained Earnings  
For the Year Ending December 31, 2017**

	<i>(millions)</i>
Retained earnings	
Balance, beginning of year .....	\$19
Net income.....	9
Less: Dividends .....	<u>(3)*</u>
Balance end of year .....	<u>\$25</u>

\*  $19 + 9 - 25 = \$3$

Dividends declared by Torrance Associates Inc. were \$3 million

**Groovy Limited**  
**Statement of Cash Flows**  
**For the Year Ended December 31, 2017**

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*(Thousands)*

<b>Cash flows from operating activities:</b>	
<b>Net income .....</b>	<b>\$300</b>
<b>Adjustments to reconcile net income to net cash provided by operating activities .....</b>	<b>60</b>
<b>Net cash provided by operating activities .....</b>	<b><u>360</u></b>
<b>Net cash used in investing activities .....</b>	<b>(400)</b>
<b>Net cash provided by financing activities .....</b>	<b><u>70</u></b>
<b>Net increase in cash .....</b>	<b>30</b>
<b>Beginning cash balance .....</b>	<b><u>95</u></b>
<b>Ending cash balance .....</b>	<b><u><u>\$125</u></u></b>

**Items given that do not appear on the statement of cash flows:**

- Total assets      — Balance sheet**
- Total liabilities — Balance sheet**

<b>FEDEX KINKO'S AT UNIVERSITY OF SASKATCHEWAN INCOME STATEMENT FOR THE MONTH ENDED JULY 31, 2017</b>		
<b>Revenue:</b>		
Service revenue .....		<b>\$14,000</b>
<b>Expenses:</b>		
Rent expense .....	\$ 700	
Office supplies expense .....	1,200	
Utilities expense .....	200	
Salary expense	<u>4,000</u>	
Total expenses.....		<u>6,100</u>
Net income .....		<u>\$ 7,900</u>

<b>FEDEX KINKO'S AT UNIVERSITY OF SASKATCHEWAN STATEMENT OF RETAINED EARNINGS FOR THE MONTH ENDED JULY 31, 2017</b>	
Retained earnings, July 1, 2017 .....	\$ 0
Add: Net income for the month.....	<u>7,900</u>
	7,900
Less: Dividends.....	<u>(2,000)</u>
Retained earnings, July 31, 2017 .....	<u>\$5,900</u>

<b>FEDEX KINKO'S AT UNIVERSITY OF SASKATCHEWAN BALANCE SHEET JULY 31, 2017</b>			
<b>Assets</b>		<b>Liabilities</b>	
Cash .....	\$ 8,100	Accounts payable.....	<u>\$ 3,200</u>
Equipment .....	<u>36,000</u>	<b>Shareholders' Equity</b>	
		Common shares .....	35,000
		Retained earnings .....	<u>5,900</u>
		Total shareholders' equity.	40,900
Total assets .....	<u>\$44,100</u>	Total liabilities and shareholders' equity.....	<u>\$44,100</u>

<b>FEDEX KINKO'S AT UNIVERSITY OF SASKATCHEWAN STATEMENT OF CASH FLOWS FOR THE MONTH ENDED JULY 31, 2017</b>
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<b>Cash flows from operating activities:</b>	
Net income .....	\$ 7,900
Adjustments to reconcile net income to cash provided by operations .....	<u>3,200</u>
Net cash provided by operating activities...	11,100
<b>Cash flows from investing activities:</b>	
Acquisition of equipment .....	<u>\$(36,000)</u>
Net cash used for investing activities.....	(36,000)
<b>Cash flows from financing activities:</b>	
Issuance (sale) of shares to owners.....	\$ 35,000
Payment of dividends .....	<u>(2,000)</u>
Net cash provided by financing activities ...	<u>33,000</u>
Net increase in cash .....	\$ 8,100
Cash balance, July 1, 2017.....	<u>0</u>
Cash balance, July 31, 2017.....	<u>\$ 8,100</u>

(10-15 min.) E 1-27

**TO: Owner of FedEx Kinko's at University of Saskatchewan**

**FROM: Student Name**

**SUBJECT: Opinion of operating results, financial position, and cash flows**

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Your first month of operations appears to have been successful. Revenues totalled \$14,000 and net income was \$7,900. These operating results look very strong.

The store was able to pay a \$2,000 dividend, and this should make you happy with so quick a return on your investment.

Your financial position looks secure, with assets of \$44,100 and liabilities of only \$3,200. Your shareholders' equity is \$40,900.

Operating activities generated cash of \$11,100. You ended the month with cash of \$8,100. Based on the above facts, I believe you should keep the University of Saskatchewan store operating.

**Note: Student responses may vary.**

- a. ***Paying large dividends*** will cause retained earnings to be low.
- b. Heavy ***investing activity*** and ***paying off debts*** can result in a cash shortage even if net income has been high. High non-cash current assets such as accounts receivable and inventories will do the same.
- c. The single best source of cash for a business is ***collections from customers*** based on delivery of goods and/or services. This source of cash is best because it results from the core operating activity of the business. Collections from customers do not create liabilities that must be paid back to anyone.
- d. ***Borrowing money, issuing (selling) shares to shareholders, and selling capital assets*** such as land, buildings, and equipment can bring in cash even during a period when the company has experienced net losses.



# Problems

Group A

(15-20 min.) P 1-29A

Req. 1

**FedEx Kinko's Special Contract Division  
Income Statement  
For the Year Ended December 31, 2017**

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Sales revenue .....	\$250,000	
Other revenue .....	<u>50,000</u>	
Total revenue .....		\$300,000
Salaries expense .....	\$ 20,000	
Other expenses .....	<u>240,000</u>	
Total operating expenses .....		<u>260,000</u>
Income before income tax .....		40,000
Income tax expense (\$40,000 × 0.30) ...		<u>(12,000)</u>
Net income .....		<u>\$ 28,000</u>

**Req. 2**

- a. Faithful representation characteristic. Report revenues at their actual sale value because that amount is supported by verifiable data and free from bias. What management believes the goods are worth is based on opinion and subject to dispute.**
- b. Historical-cost assumption. Account for expenses at their actual cost, not a hypothetical amount that the company might have incurred.**
- c. Historical-cost assumption. Account for expenses at their actual cost.**
- d. Separate-entity assumption. Each operating division of the company is a separate entity with its own financial statements. Kinko's as a whole constitutes an entity for accounting purposes.**
- e. Stable-monetary-unit assumption. Accounting in Canada ignores the effect of inflation as the dollar's purchasing power is relatively stable.**
- f. Going-concern assumption. There is no evidence that Kinko's is going out of business, so it seems safe to assume that the division is a going concern. Therefore, the potential sale value of Kinko's assets is not relevant, nor recorded.**

Computed amounts are shown in boxes.  
 Amounts in millions.

	Link Ltd.	Chain Inc.	Fence Corp.
<b>Beginning</b>			
<b>Assets</b> .....	\$78	\$ 30	<span style="border: 1px solid black; padding: 2px;">\$7</span>
<b>- Liabilities</b> .....	<u>-47</u>	<u>-19</u>	<u>-2</u>
<b>= Common shares</b> .....	6	1	2
<b>+ Retained earnings</b> .....	<span style="border: 1px solid black; padding: 2px;">\$25</span>	\$10	\$3
<b>Ending</b>			
<b>Assets</b> .....	<span style="border: 1px solid black; padding: 2px;">\$81</span>	\$48	\$9
<b>- Liabilities</b> .....	<u>-48</u>	<u>-30</u>	<span style="border: 1px solid black; padding: 2px;">-3</span>
<b>= Common shares</b> .....	6	1	2
<b>+ Retained earnings</b> .....	\$27	<span style="border: 1px solid black; padding: 2px;">\$17</span>	<span style="border: 1px solid black; padding: 2px;">\$4</span>
<b>Owner's equity</b>			
<b>Dividends</b>	\$3	2	0
<b>Income statement</b>			
<b>Revenues</b> .....	\$216	<span style="border: 1px solid black; padding: 2px;">\$153</span>	20
<b>Expenses</b> .....	<u>-211</u>	<u>-144</u>	<u>-19</u>
<b>Net income</b> .....	<u>\$ 5</u>	<u>\$ 9</u>	<u>\$ 1</u>
<b>Statement of retained earnings</b>			
<b>Beginning retained earnings</b>	\$25	\$10	\$3
<b>+ Net income (Net loss)</b> .....	5	9	1
<b>- Dividends</b> .....	<u>-3</u>	<u>-2</u>	<u>0</u>
<b>= Ending retained earnings</b>	<u><u>\$27</u></u>	<u><u>\$17</u></u>	<u><u>\$4</u></u>

Link	Chain	Fence
Retained earnings = Assets – Liabilities – Common shares \$78 – \$47 – \$6 = \$25	Retained earnings = Assets – Liabilities – Common shares \$48 – \$30 – \$1 = \$17	Assets = Liabilities + Common shares + Retained earnings \$2 + \$2 + \$3 = \$7
Assets = Liabilities + Owner's equity \$48 + \$6 + \$27 = \$81		Liabilities = Assets – Common shares – Retained earnings \$9 – \$2 – \$4 = \$3
Net income = Revenues – Expenses \$216 – 211 = \$5	Revenues = Net income + Expenses \$9 – \$144 = \$153	

	Link Ltd.	Chain Inc.	Fence Corp.
Highest net income	\$5	\$9	\$1

**Chain has the highest \$ income**

Percentage of net income to revenues	= $\frac{\$5}{\$216}$	= $\frac{\$9}{\$153}$	= $\frac{\$1}{\$20}$
	= 2.3%	= 5.9%	= 5.0%

**Chain has the highest % of net income to revenues.**

**Req. 1**

**Strides Inc.  
Balance Sheet  
July 31, 2017**

ASSETS		LIABILITIES	
Cash	\$25,000	Accounts payable	\$16,000
Accounts receivable	20,000	Note payable	<u>9,000</u>
Store fixtures	10,000	Total liabilities	25,000
Land	44,000	SHAREHOLDERS' EQUITY	
		Shareholders' equity	<u>74,000*</u>
		Total liabilities and shareholders' equity	<u>\$99,000</u>
Total assets	<u>\$99,000</u>		

**\*Total assets (\$99,000) – Total liabilities (\$25,000) =  
Shareholders' equity (\$74,000).**

**Req. 2**

**Strides is in a *better* financial position as shareholders' equity has increased by \$66,800, and liabilities have decreased by \$84,800.**

**Req. 3**

**The amounts that are not presented on the balance sheet because they are revenues or expenses, but that are presented on the income statement, are as follows:**

**Rent expense  
Salaries expense  
Advertising expense  
Sales revenue  
Interest expense**

## Req. 1

**Alexa Markowitz Realtor Inc.  
Balance Sheet  
March 31, 2017**

<b>ASSETS</b>		<b>LIABILITIES</b>	
Cash	\$ 14,000	Accounts payable	\$ 6,000
Office supplies	1,000	Note payable	<u>60,000</u>
Furniture	10,000	Total liabilities	<u>66,000</u>
Land	110,000	<b>SHAREHOLDERS'</b>	
Franchise	25,000	<b>EQUITY</b>	
		Common shares	60,000
		Retained earnings	<u>34,000*</u>
		Total shareholders' equity	<u>94,000</u>
<b>Total assets</b>	<u><u>\$160,000</u></u>	Total liabilities and	
		shareholders' equity	<u><u>\$160,000</u></u>

**\*Total assets (\$160,000) – Total liabilities (\$66,000) –  
Common shares (\$60,000) = Retained earnings (\$34,000).**

**Req. 2**

**The business can pay its debts as cash is greater than accounts payable and income was earned in the first month which can be applied to the note payable.**

**Req. 3**

**Items not reported on the balance sheet of the business were personal, and due to the separate-entity assumption, are not part of the business.**

- a. Personal cash (\$5,000)**
- e. Personal residence (\$350,000) and mortgage payable (\$100,000)**
- f. Personal account payable (\$1,800)**

**Req. 1**

**Web Services Inc.  
Income Statement  
For the Year Ended December 31, 2017**

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<b>Revenue</b>		
<b>Service revenue</b> .....		<b>\$150,000</b>
<b>Expenses</b>		
<b>Salary expense</b> .....	<b>\$40,000</b>	
<b>Rent expense</b> .....	<b>15,000</b>	
<b>Interest expense</b> .....	<b>4,000</b>	
<b>Utilities expense</b> .....	<b>3,000</b>	
<b>Property tax expense</b> .....	<u><b>2,000</b></u>	
<b>Total expenses</b> .....		<u><b>64,000</b></u>
<b>Net income</b> .....		<u><u><b>\$ 86,000</b></u></u>

**Req. 2**

**Web Services Inc.  
Statement of Retained Earnings  
For the Year Ended December 31, 2017**

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<b>Retained earnings, beginning of year</b>	<b>\$ 60,000</b>
<b>Add: Net income for the year</b> .....	<u><b>86,000</b></u>
	<b>146,000</b>
<b>Less: Dividends</b> .....	<u><b>(30,000)</b></u>
<b>Retained earnings, end of year</b> .....	<u><u><b>\$116,000</b></u></u>



Req. 3

Web Services Inc.  
Balance Sheet  
December 31, 2017

ASSETS		LIABILITIES	
Cash	\$ 8,000	Accounts payable	\$ 15,000
Accounts receivable	25,000	Interest payable	2,000
Supplies	2,000	Note payable	<u>32,000</u>
Equipment	11,000	Total liabilities	<u>49,000</u>
Building	126,000	SHAREHOLDERS'	
Land	8,000	EQUITY	
		Common shares	15,000
		Retained earnings	<u>116,000</u>
		Total shareholders' equity	<u>131,000</u>
		Total liabilities and	
Total assets	<u>\$180,000</u>	shareholders' equity	<u>\$180,000</u>

\* Total assets (\$180,000) – Total liabilities (\$49,000) –  
Common shares (\$15,000) = Retained earnings (\$116,000).

**Req. 4**

- a. Web Services was profitable in 2017, earning a net income of \$86,000.**
- b. Retained earnings increased by \$56,000 after paying dividends to shareholders of \$30,000.**
- c. Shareholders' equity exceeds liabilities by (\$131,000 – \$49,000) \$82,000. Shareholders own more of Web Services' assets.**

**As CEO, you would be pleased with the results of Web Services Inc.**

## Req. 1

**Stuart Inc.**  
**Statement of Cash Flows**  
**For the Fiscal Year Ended March 1, 2017**

	<i>(Millions)</i>
<b>Cash flows from operating activities:</b>	
Net income (loss) .....	\$(251)
Adjustments to reconcile net income (loss) to cash provided by operations .....	<u>397</u>
Net cash provided by operating activities..	146
<b>Cash flows from investing activities:</b>	
Purchases of capital assets and other assets	\$(144)
Sales of capital assets and other assets .....	<u>1</u>
Net cash used for investing activities .....	(143)
<b>Cash flows from financing activities:</b>	
Issuance of long-term debt .....	164
Repayment of long-term debt .....	(1)
Issuance of common shares .....	1
Repurchase of common shares .....	(177)
Payment of dividends .....	<u>(31)</u>
Net cash used for financing activities .....	<u>(44)</u>
Net decrease in cash .....	(41)
Cash, beginning .....	<u>41</u>
Cash, ending .....	<u><u>\$ 0</u></u>

*Req. 2*

**Operating activities provided the bulk of Stuart Inc.'s cash. This is normally a sign of financial strength. Cash available was used to invest in capital asset purchases and pay dividends. The result of investing and financing activities reduced cash available at fiscal year end to 0. This is a negative statement of cash flows.**

**Req. 1**

	2017		2016	
	<i>(Thousands)</i>			
<b>STATEMENT OF OPERATIONS</b>				
Revenues	16,800	= \$	k	\$16,000
Cost of goods sold			11,500	a = 11,100
Other expenses			<u>1,300</u>	<u>1,200</u>
Earnings before income taxes			4,000	3,700
Income taxes (35% tax rate)	1,400	=	<u>        </u> l	<u>1,300</u>
Net earnings	2,600	=	<u>\$        </u> m	<u>\$        </u> b = 2,400
<b>STATEMENT OF RETAINED EARNINGS</b>				
Beginning balance	5,700	= \$	n	\$ 3,500
Net earnings	2,600	=	o	c = 2,400
Dividends			<u>(300)</u>	<u>(200)</u>
Ending balance	8,000	=	<u>\$        </u> p	<u>\$        </u> d = 5,700
<b>BALANCE SHEET</b>				
<b>Assets:</b>				
Cash	2,400	= \$	q	\$ e = 2,000
Capital assets			3,000	1,800
Other assets	12,000	=	<u>        </u> r	<u>11,200</u>
Total assets	17,400	=	<u>\$        </u> s	<u>\$15,000</u>
<b>Liabilities:</b>				
Current liabilities	4,520	= \$	t	\$ 5,600
Notes payable and long-term debt			4,500	3,200
Other liabilities			<u>80</u>	<u>200</u>
Total liabilities			9,100	f = 9,000
<b>Shareholders' Equity:</b>				
Common shares			\$ 300	\$ 300
Retained earnings	8,000	=	<u>        </u> u	<u>        </u> g = 5,700
Total shareholders' equity	8,300	=	<u>        </u> v	<u>6,000</u>
Total liabilities and shareholders' equity	17,400	=	<u>\$        </u> w	<u>\$        </u> h = 15,000
<b>STATEMENT OF CASH FLOWS</b>				
Net cash provided by operating activities	2,100	= \$	x	\$ 1,900
Net cash provided by investing activities			(1,000)	(900)
Net cash used for financing activities			<u>(700)</u>	<u>(1,010)</u>
Increase (decrease) in cash			400	i = (10)
Cash at beginning of year	2,000	=	<u>        </u> y	<u>2,010</u>
Cash at end of year	2,400	=	<u>\$        </u> z	<u>\$        </u> j = 2,000

**Req. 2**

- a. Operations improved during 2017. Revenues increased by \$800 thousand and net earnings increased from \$2,400 thousand to \$2,600 thousand.**
- b. The company retained most of its net earnings for use in the business. Dividends were only \$200 thousand in 2016 and \$300 thousand in 2017, which are much less than net earnings.**
- c. Total assets at the end of 2017 were \$17,400 thousand. This is the amount of total resources that the company has to work with as it moves into the year 2018.**
- d. At the end of 2016 the company owed total liabilities of \$9,000 thousand. At the end of 2017 the company owed \$9,100 thousand. Although total liabilities increased marginally, there was a larger increase in total assets, which means that total shareholders' equity is increasing.**
- e. The company's major source of cash is operating activities, and cash increased in 2017 by \$400 thousand. Based on these two facts, it appears that the company's ability to generate cash is strong.**

**Req. 1**

*(Amounts in millions)*

	<b>Assets</b>	<b>=</b>	<b>Liabilities</b>	<b>+</b>	<b>Stockholders' Equity</b>
	\$240		\$150		
	350		360		
	<u>170</u>		<u>          </u>		
<b>Total</b>	<b>\$760</b>	<b>=</b>	<b>\$510</b>	<b>+</b>	<b>\$250</b>

**Req. 2** Resources to work with      **Req. 3** Amount owed to creditors      **Req. 4** Actually owned by company stockholders

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# Problems

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Group B

(15-20 min.) P 1-37B

Req. 1

**Snap Fasteners Inc.  
Income Statement  
For the Year Ended December 31, 2017**

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	<i>(Millions)</i>	
Sales revenue .....		\$56.2
Cost of goods sold .....	\$40.0	
Other expenses .....	<u>14.9</u>	
Total expenses .....		<u>54.9</u>
Income before income tax.....		1.3
Income tax expense (\$1.3 × 0.35) ..		<u>0.5</u>
Net income.....		<u><u>\$ 0.8</u></u>



**Req. 2**

- a. Historical-cost assumption. Account for expenses at their actual cost.**
- b. Separate-entity assumption. Each division of the company is a separate entity, and the company as a whole constitutes an entity for accounting purposes.**
- c. Stable-monetary-unit assumption. Accounting in Canada ignores the effect of inflation as the dollar's purchasing power is relatively stable.**
- d. Going-concern assumption. There is no evidence that Snap Fasteners Inc. is going out of business, so it seems safe to assume that the company is a going concern. Therefore, the potential sale value of Snap's assets is not relevant, nor recorded.**
- e. Faithful representation characteristic. Report revenues at their actual sale value because they can be verified by sales transactions and are free from bias.**
- f. Historical-cost assumption. Account for expenses at their actual cost, not a hypothetical amount that the company might have incurred if the products were purchased outside.**

**Req. 1**

**Beckwith Garden Supply, Inc.  
Income Statement  
Year Ended December 31, 2017**

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<b>Revenue</b>		
Service revenue.....		<b>\$457,600</b>
<b>Expenses</b>		
Salary expense .....	<b>\$108,500</b>	
Rent expense.....	<b>40,600</b>	
Interest expense.....	<b>10,200</b>	
Utilities expense.....	<b>8,500</b>	
Property tax expense.....	<u><b>7,300</b></u>	
Total expenses .....		<u><b>175,100</b></u>
Net income .....		<u><b>\$282,500</b></u>

**Req. 2**

**Beckwith Garden Supply, Inc.  
Statement of Retained Earnings  
Year Ended December 31, 2017**

---

Retained earnings, December 31, 2016.....	<b>\$ 364,200</b>
Add: Net income .....	<u><b>282,500</b></u>
Subtotal	<b>646,700</b>
Less: Dividends declared .....	<u><b>(106,000)</b></u>
Retained earnings, December 31, 2017 .....	<u><b>\$ 540,700</b></u>

**Req. 3**

**Beckwith Garden Supply, Inc.**  
**Balance Sheet**  
**December 31, 2017**

ASSETS		LIABILITIES	
Cash	\$ 41,000	Accounts payable	\$ 24,000
Accounts receivable	84,600	Note payable	99,500
Supplies	6,800	Interest payable	<u>2,500</u>
Land	27,000	Total liabilities	126,000
Building	401,000	<b>STOCKHOLDERS'</b>	
Equipment	119,000	<b>EQUITY</b>	
		Common stock	12,700
		Retained earnings	<u>540,700</u>
		Total stockholders' equity	553,400
		Total liabilities and	
Total assets	<u>\$679,400</u>	stockholders' equity	<u>\$679,400</u>

**Req. 4**

- a. Beckwith Garden Supply was profitable; net income was \$282,500.
- b. Retained earnings increased by \$176,500 — from \$364,200 to \$540,700.
- c. Stockholders' equity (\$553,400) exceeds liabilities (\$126,000).

**The stockholders have a greater claim against Beckwith Garden Supply's assets than do the company's creditors.**

Computed amounts are shown in boxes. Amounts are in millions.

	<u>Gas Limited</u>	<u>Groceries Inc.</u>	<u>Bottlers Corp.</u>
<b>Beginning:</b>			
<b>Assets</b>	\$11,200	\$ 3,256	\$ 909
– <b>Liabilities</b>	<u>(4,075)</u>	<u>(1,756)</u>	<u>(564)</u>
<b>= Owners' equity</b>	<u>\$ 7,125</u>	<u>\$ 1,500</u>	<u>\$ 345</u>
<b>Ending:</b>			
<b>Assets</b>	\$12,400	\$ <u>3,389</u> <sup>2</sup>	\$1,025
– <b>Liabilities</b>	<u>(4,400)</u>	<u>(1,699)</u>	<u>(565)</u>
<b>= Owners' Equity</b>	<u>\$ 8,000</u>	<u>\$ 1,690</u>	<u>\$ 460</u>
<b>Owners' Equity:</b>			
<b>Issuance (repurchase) of shares</b>	\$ (36)	\$ (0)	\$ <u>20</u> <sup>3</sup>
– <b>Dividends</b>	(341)	(30)	(0)
<b>Income Statement:</b>			
<b>Revenues</b>	\$11,288	\$11,099	\$1,663
– <b>Expenses</b>	<u>(10,036)</u> <sup>1</sup>	<u>(10,879)</u>	<u>(1,568)</u>
<b>= Net income (Net loss)</b>	<u>\$ 1,252</u>	<u>\$ 220</u>	<u>\$ 95</u>
<b>Statement of owners' equity</b>			
<b>Beginning owners' equity</b>	\$ 7,125	\$ 1,500	\$ 345
+ <b>Issuance (repurchase) of stock</b>	(36)	(0)	<u>20</u> <sup>3</sup>
+ <b>Net income (Net loss)</b>	<u>1,252</u> <sup>1</sup>	220	95
– <b>Dividends</b>	<u>(341)</u>	<u>(30)</u>	<u>0</u>
<b>= Ending owners' equity</b>	<u>\$ 8,000</u>	<u>\$ 1,690</u>	<u>\$ 460</u>

(continued) P 1-39B

<sup>1</sup>Net income = Ending owners' equity – beginning owners' equity + repurchase of stock + dividends

Net income =  
\$8,000 – 7,125 + 36 +  
341 = \$1,252

<sup>2</sup>Assets – liabilities = OE

Revenue – expenses = net income  
\$11,288 – expenses = \$1,252

Expenses = \$10,036

Assets = \$1,699 + \$1,690

Assets = \$3,389

<sup>3</sup>\$345 + Issuances of stock + 95 – \$0 = \$460

Issuances of stock = \$20

		<u>Gas Limited</u>	<u>Groceries Inc.</u>	<u>Bottlers Corp.</u>
Highest net income	=	\$1,252 highest	\$220	\$95
Percentage of net income to revenues	=	$\frac{\$1,252}{\$11,288}$	$\frac{\$220}{\$11,099}$	$\frac{\$95}{\$1,663}$
		= 11.1% highest	= 2.0%	= 5.7%

**Req. 1**

**Lunenberg Times Inc.  
Balance Sheet  
October 31, 2017**

ASSETS		LIABILITIES	
Cash	\$ 25,000	Accounts payable	\$ 8,000
Accounts receivable	10,000	Note payable	<u>16,000</u>
Inventory	30,000	Total liabilities	<u>24,000</u>
Office furniture	15,000	SHAREHOLDERS'	
Land	34,000	EQUITY	
		Shareholders' equity	<u>90,000*</u>
		Total liabilities and	
Total assets	<u>\$114,000</u>	shareholders' equity	<u>\$114,000</u>

**\*Total assets (\$114,000) – Total liabilities (\$24,000) = Shareholders' equity (\$90,000).**

**Req. 2**

**Lunenberg Times Inc. is in a *better* financial position. Shareholders' equity has increased by \$71,500, while liabilities have decreased by \$84,000.**

**Req. 3**

**The accounts that are not presented on the balance sheet because they are revenues or expenses, but which are presented on the income statement, are as follows:**

**Sales revenue  
Rent expense  
Advertising expense  
Salary expense**

Req. 1

**Luis Fontano Realtor Inc.  
Balance Sheet  
July 31, 2017**

ASSETS		LIABILITIES	
Cash	\$ 10,000	Accounts payable	\$ 10,000
Office supplies	1,000	Note payable	<u>80,000</u>
Furniture	18,000	Total liabilities	<u>90,000</u>
Land	135,000	SHAREHOLDERS'	
Franchise	35,000	EQUITY	
		Common shares	75,000
		Retained earnings	<u>34,000*</u>
		Total shareholders' equity	<u>109,000</u>
		Total liabilities and	
Total assets	<u>\$199,000</u>	shareholders' equity	<u>\$199,000</u>

**\*Total assets (\$199,000) – Total liabilities (\$90,000) –  
Common shares (\$75,000) = \$34,000.**

**Req. 2**

**The realty business has \$10,000 in cash and owes \$10,000 as a current liability. The value of the land likely exceeds the note payable. Therefore, it does appear that the realty business can pay its debts.**

**Req. 3**

**Personal items not reported on the balance sheet of the business:**

**a. Personal accounts payable (\$5,000)**

**c. Personal cash (\$5,000)**

**f. Personal residence (\$300,000) and mortgage payable (\$125,000)**



**Req. 1**

**Auto Mechanics Ltd.  
Income Statement  
For the Year Ended December 31, 2017**

<b>Revenue</b>		
Service revenue .....		<b>\$210,000</b>
<b>Expenses</b>		
Salary expense .....	<b>\$85,000</b>	
Rent expense.....	<b>6,000</b>	
Advertising expense.....	<b>10,000</b>	
Interest expense.....	<b>4,000</b>	
Property tax expense.....	<b><u>5,000</u></b>	
Total expenses .....		<b><u>110,000</u></b>
Net income.....		<b><u><u>\$100,000</u></u></b>

**Req. 2**

**Auto Mechanics Ltd.  
Statement of Retained Earnings  
For the Year Ended December 31, 2017**

Retained earnings, beginning of year.....	<b>\$ 40,000</b>
Add: Net income for the year .....	<b><u>100,000</u></b>
	<b>140,000</b>
Less: Dividends .....	<b><u>(50,000)</u></b>
Retained earnings, end of year.....	<b><u><u>\$ 90,000</u></u></b>

**Req. 3**

**Auto Mechanics Ltd.  
Balance Sheet  
December 31, 2017**

ASSETS		LIABILITIES	
Cash	\$ 10,000	Accounts payable	\$ 21,000
Accounts receivable	25,000	Salary payable	12,000
Supplies	3,000	Note payable	<u>95,000</u>
Furniture	20,000	Total liabilities	128,000
Building	140,000	<b>SHAREHOLDERS'</b>	
Land	95,000	<b>EQUITY</b>	
		Common shares	75,000
		Retained earnings	<u>90,000</u>
		Total shareholders' equity	<u>165,000</u>
		Total liabilities and	
Total assets	<u><u>\$293,000</u></u>	shareholders' equity	<u><u>\$293,000</u></u>

**\*Total assets (\$293,000) – Total liabilities (\$128,000) – Common shares (\$75,000) = Retained earnings (\$93,000).**

**Req. 4**

- a. Auto Mechanics Ltd. was profitable in 2017. The company's net income was \$100,000.
- b. Retained earnings increased by \$50,000.
- c. Shareholders' equity is greater than liabilities by (\$165,000 – \$128,000) \$37,000. The shareholders own more Auto Mechanics Ltd. assets than do the creditors.

**Req. 1**

**Long Boat Ltd.**  
**Statement of Cash Flows**  
**For a Recent Year (*in thousands*)**

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<b>Cash flows from operating activities:</b>		
Net income .....	\$	180
Adjustments to reconcile net income to cash provided by operations .....		<u>65</u>
Net cash flow from operating activities .....		245
 <b>Cash flows from investing activities:</b>		
Purchases of capital assets .....	\$(123)	
Sales of capital assets .....	2	
Net cash outflow for investing activities ....		(121)
 <b>Cash flows from financing activities:</b>		
Payment of dividends .....	(24)	
Issuance of common shares .....	4	
Change in bank loan .....	(44)	
Payment of long-term debt.....	<u>(26)</u>	
Net cash inflow from financing activities		<u>(90)</u>
Net increase in cash .....	\$	34
Cash, beginning .....		<u>(11)</u>
Cash, ending.....	\$	<u><u>23</u></u>

**Req. 2**

Operations were the main source of cash, which is a sign of strength. Funds from operations provided funds for investing and financing needs with a net increase in cash indicating financial strength.

## Req. 1

		2017	2016		
		(Thousands)			
<b>STATEMENT OF INCOME</b>					
Revenues		\$94,500		a	= 88,250
Cost of goods sold	\$73,195	=	k	65,400	
Other expenses		<u>15,660</u>		<u>13,550</u>	
Income before income taxes		5,645		9,300	
Income taxes (35%)				<u>3,450</u>	
		<u>1,975</u>			
Net income	3,670	=	<u>\$ l</u>	<u>\$ b</u>	= 5,850
<b>STATEMENT OF RETAINED EARNINGS</b>					
Beginning balance	15,400	=	\$ m	\$10,000	
Net income	3,670	=	n	c	= 5,850
Dividends			<u>(480)</u>	<u>(450)</u>	
Ending balance	18,590	=	<u>\$ o</u>	<u>\$ d</u>	= 15,400
<b>BALANCE SHEET</b>					
<b>Assets:</b>					
Cash	450	=	\$ p	\$ 400	
Capital assets			23,790	e	= 20,200
Other assets	19,250	=	<u>q</u>	<u>17,900</u>	
Total assets	43,490	=	<u>\$ r</u>	<u>\$38,500</u>	
<b>Liabilities:</b>					
Current liabilities			\$11,100	\$10,000	
Long-term debt and other liabilities	13,400	=	<u>s</u>	<u>12,500</u>	
Total liabilities			<u>24,500</u>	<u>f</u>	= 22,500
<b>Shareholders' Equity:</b>					
Common shares			\$ 400	\$ 600	
Retained earnings	18,590	=	<u>t</u>	<u>g</u>	= 15,400
Total shareholders' equity	18,990	=	<u>u</u>	<u>16,000</u>	
Total liabilities and shareholders' equity	43,490	=	<u>\$ v</u>	<u>\$ h</u>	= 38,500
<b>STATEMENT OF CASH FLOWS</b>					
Net cash provided by operating activities	2,500	=	\$ w	\$ 3,600	
Net cash used for investing activities			(2,700)	(4,150)	
Net cash provided by financing activities			<u>250</u>	<u>900</u>	
Increase (decrease) in cash			50	i	= 350
Cash at beginning of year	400	=	<u>x</u>	<u>50</u>	
Cash at end of year	450	=	<u>\$ y</u>	<u>\$ j</u>	= 400

**Req. 2**

- a. Operations deteriorated during 2017. The income statement reports that revenues increased, but net income fell from \$5,850 thousand to \$3,670 thousand. Cost of goods sold increased as a percentage of revenue (77.5% vs. 74.1%).**
- b. The company retained most of its net income for use in the business. The statement of retained earnings reports that paid dividends were \$480 thousand in 2017 and \$450 thousand in 2016, which are much less than net income.**
- c. The balance sheet reports total assets at the end of 2017 were \$43,490 thousand. This is the amount of total resources that the company has to work with as it moves into the year 2018. At the end of 2016 the balance sheet shows that the company had total assets of \$38,500 thousand.**
- d. The balance sheet shows that at the end of 2016, the company owed total liabilities of \$22,500 thousand and at the end of 2017, the company owed \$24,500 thousand.**
- e. The statement of cash flows reports that the company's major source of cash is operating activities, and cash is increasing. Based on these two facts, it appears that the company's ability to generate cash is strong despite the dip in 2017 net income. The company is using most of its cash to invest. It is clear from the large amounts of cash used for investing activities that the company is growing.**

# Decision Cases

(20-30 min.) Decision Case 1

## Req. 1

Based solely on these balance sheets, PC Providers Inc. (PPI) appears to be the better credit risk than Web Services Corporation (WSC) because,

1. WSC has more assets (\$430,000) than PPI (\$223,000), but WSC owes much more in liabilities than PPI (\$390,000 versus \$40,000). PPI's shareholders' equity is far greater than WSC's (\$183,000 compared to \$40,000). PPI is not heavily in debt, but WSC is.
2. The student should consider the borrower's ability to pay the loan. WSC has large liabilities to pay, and has very little shareholders' equity. PPI has little debt to pay before undertaking a new loan. The income statement and statement of cash flows should also be considered.

## Req. 2

1. The student should request that the borrower present the entity's *income statement* for a recent period, such as the most recent month, the most recent three months, and the last year. The income statement reports the revenues earned by the entity, the expenses it incurred, and the net income or net loss for the periods. Income statement data (especially the amount of net income or net loss) provide an important measure of business success or failure, in particular over recent fiscal periods.

- 2. The student should request that the borrower present the entity's statement of cash flows for the most recent period. In particular he or she would want to know how the borrower generates cash—from operating, investing, or financing activities. If cash from operations is strong, WSC may be able to cover large debt obligations.**
  
- 3. What the borrower plans to do with the loan will affect the decision – investment in assets to generate greater revenue would provide greater opportunity for a loan provision.**

(15-20 min.) Decision Case 2

1.

**My Dream Inc.  
Income Statement  
For the Year Ended December 31, 2017**

Revenues (\$80,000 + \$10,000)	\$90,000
Expenses (\$60,000 + \$20,000 + \$10,000)	<u>90,000</u>
Net income	<u>\$ 0</u>

**My Dream Inc.  
Balance Sheet  
December 31, 2017**

Cash	\$13,000	Liabilities (\$35,000 + \$10,000)	\$45,000
Accounts receivable	10,000	Equity (\$45,000 – \$20,000)	<u>25,000</u>
Other assets			
(\$67,000 – \$20,000)	<u>47,000</u>		
	<u>\$70,000</u>		<u>\$70,000</u>

2. The balance sheet indicates that My Dream has greater debt than shareholder equity. The statement of cash flows would provide information as to how much of the debt relates to investment in assets to generate revenue in the future.

The income statement indicates the company broke even with neither a profit nor a loss in its first year.

3. I would buy shares in the company if my friend would invest more or find other investors, and if she would also commit to getting a competent accountant to keep her records and prepare her financial statements.

**Note:** Student responses may vary.



# **Ethical Issue 1**

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**Note to instructor: student responses will vary on this problem. Keep the discussion pointed toward use of the multiple-criteria model for making good ethical decisions, pointing out elements of students' reasoning that may be faulty or incomplete. It might be useful to have a debate or role play, assigning students to different sides of the issue (for or against accepting a copy of the exam).**

## ***Req. 1***

**The fundamental ethical issue in this situation is whether you should accept a copy of the old exam from your friend.**

## ***Req. 2***

**The stakeholders are:**

- a. You**
- b. Your friend**
- c. The remainder of the students in the class**
- d. The professor**
- e. The University**
- f. Your family**

**(This may not be a complete list; you may think of more.)  
Consequences are discussed in requirement 3.**

**Req. 3**

**Analysis of the problem:**

- a. Economic perspective:** If use of the old exam turns out to help you (it may not) you might improve your grade and allow you to retain your scholarship. This might help you and your family financially. If you use the exam to your unfair advantage, and you are reported, you and possibly your friend might receive grades of F in the class although you might otherwise have passed. This could cause adverse economic consequences to you, your friend and your families.
  
- b. Legal perspective:** Although it may not violate local or federal law, giving or accepting copies of old exams may violate the university's honor code, which serves the same purpose of a legal code in this case. If you use the old exam and it turns out that you violated the University's honor code, both you and your friend could be in trouble. Your family and your friend's family could also be impacted by any adverse consequences to you or her. Academic institutions establish policies against academic dishonesty because cheating hurts everyone—the student who commits the act, the other students in the class whose rights to fair treatment are violated by cheating, the professor, who must endure hours of investigating, reporting, and perhaps testifying.
  
- c. Ethical perspective.** Receiving questionable help from others in the face of policies that prohibit it is, at best, risky, and at worst, downright wrong. Cheating is similar to

## **(continued) Ethical Issue 1**

**stealing, since it is stealing the work of another without their permission. It is usually accompanied by lying to cover it up, or at least, not concealing the truth. Cheating violates other students' rights to fair and equal treatment. It violates the instructor's rights to run a course as a "fair game" for all participants. Because the students and faculty are hurt by cheating, the university is hurt too. If cheating goes unpunished, grades are inflated, ultimately damaging the academic reputation of the institution and eroding the value of its degrees. Parents of students who are caught cheating have to endure the agony of working through the problem with their son or daughter, and perhaps the social stigma that comes from adverse publicity.**

**These are just some of the arguments against cheating. Of course, there is a question in this case as to whether taking the test actually violates the professor's or the university's policies.**

**Req. 4**

**It would be helpful to find out what the professor's policies are with respect to use of fraternity and sorority test files. The university might have a blanket policy on this. (Some students might spend a little time researching this by reading the university's honor code on their web site; just reading the honor code will be an eye-opening experience for most students). Advise your students to research the use of fraternity and sorority test files on the university web site, or to discuss the issue with the head of the department or the chair of the university honor council.**

**Unfortunately, in this case, there is not much time. Researching the issue in the university's honor code takes valuable time away from studying for the exam, which, if you do, could help you raise your grade and solve the whole problem!**

**Probably the best solution to this problem is "when in doubt, don't." You may not do well on the test, but at least you won't have to live with the terrible consequences of being accused as a cheater. It should make you feel better in the long run that, although you may not make the highest grades in the class, at least you are not a cheater.**

**Req. 5**

**Cheating is very closely related to stealing, which is a form of fraud. When employees steal from their companies, they steal property that belongs to others. There are economic, legal, and ethical consequences to the company, the employee and their families, and customers (who ultimately have to pay for fraud through higher prices).**

## Ethical Issue 2

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Hill should report the errors to Armour because Armour is Hill's supervisor, and Armour is responsible for the errors. If Armour fails to take action, then Hill should report the errors to the manager of the organization. In any event, outsiders who are relying on Stainton Hardware's financial statements must be made aware of the need to correct the reported net income figure.

### (30 min.) Canadian Tire Corporation

1. ***Net income***, This item is important as it expresses the net result of all the income minus all the expenses for a period. Net income gives the results of operations in a single figure.

During fiscal year 2014, net income increased from \$564.4 million to \$639.3 million. This increase of 13% is great news for CANADIAN TIRE and its investors.

2. Canadian Tire's largest expense is for the cost of producing revenue, which amounted to \$8,416.9 million in 2014 and \$8,063.3 in 2013. These costs represent 67.5% and 68.4% of total revenues in each year. This item consists primarily of the cost of goods sold to customers during the year. These goods would include the bikes, auto parts, sporting goods, clothes, and other items sold under the various Canadian Tire retail banners.

The expense is less than revenue because Canadian Tire runs its business to earn a profit. If this expense exceeded net sales revenue, the company would be in financial difficulty.

**(continued) Canadian Tire Corporation**

**3. Total resources (total assets) at the end of 2014 ..... \$14,553.2 million**

**Amount owed (total liabilities) at the end of 2014 ..... \$8,922.4 million**

**Portion of the company's assets owned by the  
company's shareholders (this is shareholders'  
equity)..... \$5,630.8 million**

**Canadian Tire's accounting equation is (*in millions*):**

<b>Assets</b>	<b>=</b>	<b>Liabilities</b>	<b>+</b>	<b>Shareholders' equity</b>
<b>\$14,553.2</b>	<b>=</b>	<b>\$8,922.4</b>	<b>+</b>	<b>\$5,630.8</b>

**4. At the beginning of fiscal year 2014 Canadian Tire had cash of \$643.2 million, and at the end of the year Canadian Tire had cash of \$662.1 million. Canadian Tire gets most of its cash from operating activities.**

**Canadian Tire spent \$589.5 million in cash on investing activities, primarily the purchase of property and equipment (\$538.6 million).**



## **Focus on Analysis**

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**(30 min.) Canadian Tire Corporation**

- 1. Canadian Tire's financial condition looks strong because its assets significantly exceed its liabilities on the balance sheet, both its revenues and net income have increased significantly from 2013, and it generated significant cash flows from operating activities.**
  
- 2. Net earnings for 2014 amounted to \$639.3 million. This is shown on the Net Income line on the Statement of Income. This is good news for the company, as it made money during the year, and its net income also increased by about 13% compared to 2013.**
  
- 3. The balance sheet reports cash as part of Canadian Tire's financial position. The statement of cash flow tells why cash increased or decreased during the year. The items that caused the biggest changes in Canadian Tire's cash were:**
  - Cash inflows from operating activities of \$574.8 million**
  - Additions to property and equipment of \$538.6 million**
  - Dividends of \$642 million**

## **Group Project 1**

**Answers will vary with the company chosen by students.**

## **Group Project 2**

**Answers will vary with the company created by students.**